

# Structural Changes in China's Import Market for Domestic Demand and Implications

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In response to changes in internal and external conditions such as the pursuit of sustainable growth and the global recession, China is switching its economic growth strategy to domestic demand-led growth. For this purpose, the country is promoting various plans to boost domestic demand involving heightened urbanization, service sector development, better income distribution, and a broader social security system, and is also working to suppress processing trade, enhance domestic companies' import-substituting capacity and productivity, and seek industrial upgrading. As a result, imports for processing trade have witnessed a decline, while general trade targeting China's internal consumption (domestic demand) is rapidly increasing.

## Structural Changes in China's Import Market for Domestic Demand

The global financial crisis led to a significant slowdown in the growth of China's import market. Meanwhile, the weight of general

trade import for domestic demand started to increase since the mid-2000s, and has been on an upward trajectory since exceeding 50% for the first time in 2008 (42.1% in 2006 to 56.6% in 2014). On the other hand, the proportion of processing trade import has dropped rapidly since the mid-2000s (41.0% in 2006 to 26.8% in 2014). This indicates that China's import structure is shifting focus to general trade. Moreover, owing to China's processing trade control policy and the slowdown in China's exports to developed countries, such structural changes are expected to intensify.

### Analysis by Processing Phase

China's total import market is still focused on intermediate goods (47.6% in 2014), while general trade import (import market for domestic demand) has switched to a structure focused on primary commodities since 2010 (classification by broad economic categories). This is because primary commodities imports are essential for economic growth and industrial development in China. In addition, since the intermediate goods imported into China are mainly exported after processing, they appear to account for a lower share of general

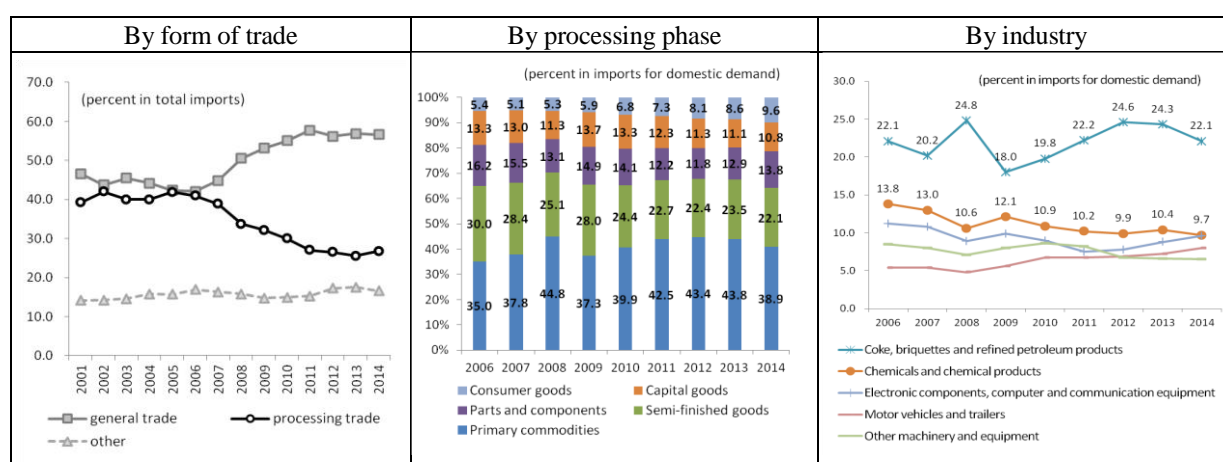
trade import.

The proportion of intermediate goods in both China's total import and general trade import has decreased. In particular, the share of semi-finished goods in the general trade import market has fallen significantly (28.0% in 2009 to 22.1% in 2014). This is because the proportion of the industrial raw material (mainly chemicals and primary metal-related products) of semi-finished products has decreased markedly (24.5% in 2009 to 19.8% in 2014). This is likely due to increased production, namely the effect of import substitution, in the heavy

chemical and materials industry in China, induced by growing industrial investment in facilities and industrial upgrading.

The ratio of consumer goods to China's general trade import is still as low as the 10% level, but the growth rate of imports is substantially faster as compared to the goods of other processing steps (27.7% in 2009-2014). In particular, the ratio of motor vehicles, household food and beverages (especially processed ones) and non-durable consumer goods imports is relatively high and is climbing steadily over a 20-30% import growth rate.

Figure 1. Structural Changes in China's Import Market for Domestic Demand



Source: Chinese trade statistics compiled by Korea International Trade Association; China Customs Statistics.

## Analysis by Industry

The manufacturing industry plays a crucial role in both China's total import and general trade import, but has recently been witnessing a rapid decline in share.

While electronic components, computers, communications equipment manufacturing account for the highest share in China's total import market (23.8% in 2014), coke, briquettes, and refined petroleum products are the

largest contributor to the general trade import market (22.1% in 2014).

The proportion of chemicals and chemical products, other machinery and equipment manufacturing of the top five industries in general trade import has recently decreased, while the share of motor vehicles and trailer manufacturing has been rising at a steady pace.

The share of food and beverages, pharmaceuticals and medicinal chemicals imports is not

significant, but is growing swiftly.

## Analysis of Korea's Exports to China for Domestic Demand

Despite China's import market, as mentioned above, having mostly converted to general trade, Korea's export to China is still defined by a structure of export-oriented processing trade. Such features are more apparent when compared to major competitors in China's import market, such as the U.S., Germany, Japan and Taiwan. The proportion of general trade exports to China from developed countries such as the U.S. (78% in 2014), Germany (60.6% in 2014) and Japan (51.4% in 2014) is overwhelmingly high. It is interesting to note that Taiwan (50.2% in 2014), which maintained an export-oriented processing trade structure similar to Korea's (51.9% in 2014), recently cut the proportion of processing trade exports to China (70.7% in 2006). Korea has not taken similar steps. In other words, while Korea's major competitors have been relatively quick to adapt to the shift in China's import market, Korea still holds on to its China-bound export-oriented processing trade structure (53.3% in 2009 to 51.9% in 2014).

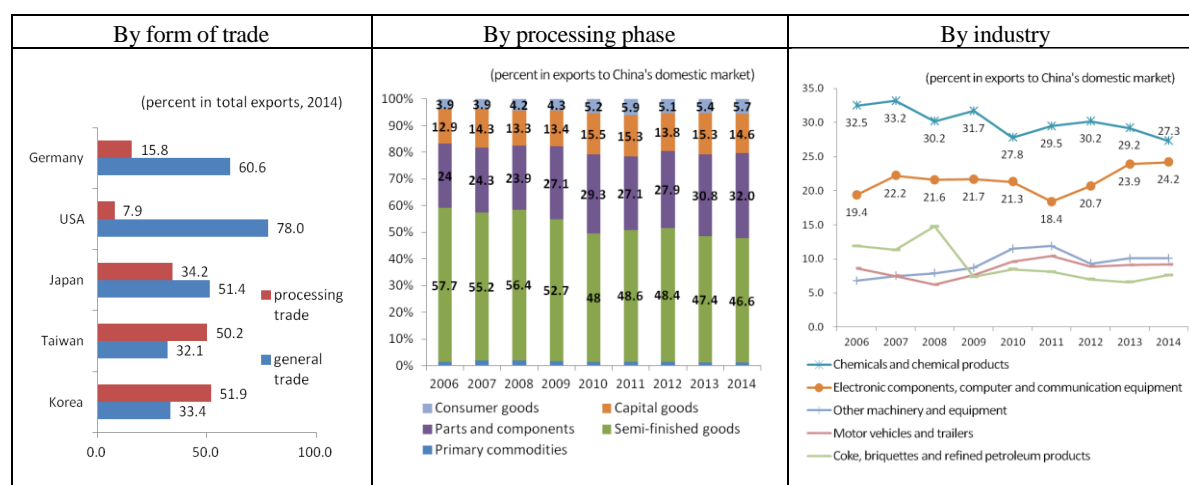
### Analysis by Processing Phase

China's import market for domestic demand has made the transition to a primary commodities-based structure, while the structure of Korea's general trade export to China is still concentrated on intermediate goods at a share reaching 78.6%. While the share of semi-finished goods of these intermediate goods is on a slight downward trend (52.7% in 2009 to 46.6% in 2014), the proportion of parts and components (especially for capital goods) has recently been rising at a relatively stable pace

(27.1% in 2009 to 32.0% in 2014). As noted above, this is because there was an evident decline in chemicals and primary metal-related products of semi-finished goods exports for China's domestic demand, while electronic components, computers, communications equipment of parts and components exports expanded rapidly. Such structural changes in Korea's intermediate goods exports to China's domestic market are closely related to the increase of import substitution effects due to increased capex and production for the heavy chemical, components and materials industries in China, as well as to the growing demand for key components and high-tech components required for its industrial upgrading.

Although consumer goods are quickly accounting for a larger share in China's general trade import, the share of consumer goods in Korea's exports to China's domestic market is very minimal (5.7% in 2014). Still, durable consumer goods such as food and beverages, electrical equipment, and non-durables such as cosmetics have driven the recent swift increase in the share of consumer goods in China-bound exports.

Figure 2. Structural Changes in Korea's Export to China for Domestic Demand



Source: Chinese trade statistics compiled by Korea International Trade Association; China Customs Statistics.

## Analysis by Industry

An examination of Korea's export to China shows that export concentration in the top two manufacturing industries is very high. The proportion of electronic components, computers and communications equipment manufacturing is overwhelming, at 50%, and the share of chemicals and chemical products takes up 27.3% of total export to China. Likewise, in export to China's domestic market, chemicals and chemical products, electronic components, computers and communications equipment manufacturing account for considerably high shares, at 27.3% and 24.2%, respectively.

However, such manufacturing industries, which account for a large share of Korea's export to China, are the main sectors that are witnessing a cutback in their share in China's import market.

On an additional note, exports of household food and beverages, pharmaceuticals and medicinal chemicals are swiftly on the rise.

## Implications

Given the recent changes in China's import market in the form of trade and import structure by processing phase and by industry, and expectations that these changes are to be sustained, countermeasures are called for.

First, since the transition of China's import structure shifted its focus to general trade, exports to China should likewise undergo a structural change in accordance with the evolving needs of China's domestic market. Despite being one of China's top five importing countries, Korea did not successfully shift gear in accordance with the structural changes in China's import market, compared to the other four countries. Of course, it may appear a difficult task to quickly transform the structure of Korea's export to China, on account of it being a vertical structure oriented toward intermediate trade. Nevertheless, we cannot ignore the fact that Taiwan and Japan are adjusting their export structures at a much faster pace than Korea.

Structural changes are taking place in China's

import market for domestic demand, as seen in the falling share of intermediate goods and growing proportion of primary commodities and consumer goods. However, the proportion of intermediate goods is still quite significant, which indicates that Korea's exports also hold an advantage. Also, since China's import for domestic demand is increasing faster than import for processing trade due to internal and external factors, Korea should raise its export of intermediate goods to the Chinese domestic market.

Finally, it will be necessary to expand consumer goods export to China's domestic market. The share of consumer goods in China's general trade import is still small, at less than 10%, but displays the most rapid import growth rate. Thus, we should encourage the export of consumer goods to secure a firm footing in the domestic market, and pioneer new markets in China. In recent years, e-commerce has emerged as a new consumption trend in China. More Chinese consumers are making foreign purchases through e-commerce, of which over 34% originates from Korea. This implies the need to further develop e-commerce as a means to boost consumer goods exports. 